

(D*R*A*F*T-3 / 97)
Initial Public Participation Working Group Draft
of the
Constitutional Nexus Guideline for Application of
a State's Sales and Use Tax to an Out-of-state Business

John James' Suggested Revisions to Lines 1-105

I. Preliminary Comments.

- A. *Differentiating a sales tax, a use tax, and a use tax collection duty.* A state sales or use tax can potentially arise in three different contexts with respect to an **out-of-state business**: (i) the application of a sales tax; (ii) the application of a use tax; and (iii) the imposition of a use tax collection duty with respect to a third-party's obligation to pay the use tax to the taxing State.
- B. *Form of sales and use taxes.* There are three types of sales and use taxes: a vendee form, a vendor form and a combined form. A vendee sales tax is a sales tax that places the legal incidence of the tax on the purchaser, even though the seller may be required to collect and remit the tax from collections made from the purchaser. A tax that places the legal incidence of the sales tax on the seller but also requires the seller to collect the tax from the purchaser is also a vendee sales tax. A vendor sales tax is a sales tax that places the legal incidence of the tax on the seller, even though the seller may have the option to collect the tax from the purchaser. A combined sales tax is a sales tax that displays aspects of both a vendee form and a vendor form.
- C. *Nexus.* One necessary condition to the application of a state sales tax or a state use tax, or the imposition of a use tax collection duty, is the satisfaction of the U.S. constitutional requirement of nexus. Nexus means there is sufficient connection with the taxing State for that State to apply its sales or use tax or to impose a use tax collection duty.
- D. *Limitation of application of Guideline.* This Guideline describes when ~~under the U.S. Constitution the Multistate Tax Commission and any adopting state contend that~~ sales and use tax nexus with respect to an **out-of-state business** is present under the U.S. Constitution and applicable state law. [It is expected that each adopting state in which the state statutory

standard for nexus is less expansive than the views expressed herein will modify this Guideline to reflect its statutory standard.] The existence of nexus ~~must be present~~ is an independent question in each of three possible circumstances for which a state sales and use tax may apply: the application of a state sales tax, the application of a state use tax, and the imposition of a use tax collection duty. The Guideline does not extend beyond sales and use taxes. In using the Guideline to determine the presence of nexus under the U.S. Constitution, users, in addition to determining the presence of nexus with respect to an **out-of-state business**, must also determine in the first instance whether, based upon applicable state law, the taxing State's sales and use tax applies at all and if so, how. This Guideline does not address these state law considerations, but the Multistate Tax Commission strongly encourages states to adopt statutory and regulatory nexus standards in accordance with this Guideline. ~~Determination of state statutory nexus is the province of the state legislatures.~~

II. *Due Process Clause and Commerce Clause define nexus.* The Due Process Clause and the Commerce Clause of the U.S. Constitution define U.S. constitutional nexus. Before a taxing State may apply a sales tax or a use tax, or impose a use tax collection duty, the application or imposition must satisfy the nexus requirements of both Clauses.

A. Due Process Clause Nexus. "Minimum contacts nexus" is the term that describes the Due Process Clause component of nexus. A determination of minimum contacts nexus is made by reference to the quality and quantity of contacts with the taxing State. Minimum contacts nexus involves notions of fairness and substantial justice in the application of the sales tax or use tax, or the imposition of a use tax collection duty.

1. Under minimum contacts nexus, a sales tax (~~whether in vendee, vendor, or combined form~~) may be applied to a taxable sale ~~concluded by in~~ which an **out-of-state business** is the purchaser, when the taxable sale occurs in the taxing State.

2. Under minimum contacts nexus, a sales tax in vendee form may be applied to a taxable sale in which an **out-of-state business** is the purchaser when the taxable sale occurs in the taxing State, provided that the purchaser takes delivery in the taxing state through an employee or agent other than a business providing transportation service. The place of passage of title is not relevant.

3. ~~2.~~ Under minimum contacts nexus, a use tax (whether the sales tax for which the use tax compensates is a vendee, vendor, or combined form) may be applied to a taxable use of the **out-of-state business**, when the taxable use occurs in the taxing State, provided the out-of-state business has not established that its presence is *de minimis*.

4. ~~3.~~ Under minimum contacts nexus, a use tax collection duty may be imposed on an **out-of-state business**, when

a. The **out-of-state business** is physically present in the taxing State, *provided*, the **out-of-state business** has not established that its presence is *de minimis*; or

b. The **out-of-state business** purposefully seeks to avails itself of the benefits of an economic market in the taxing State, either on its own or through a **representative**, and the magnitude of the contacts satisfies notions of fairness and substantial justice in imposing a use tax collection duty, provided, the use tax collected pertains to the business occurring in the economic market of the taxing State; or

c. ~~the out-of-state business engages, either on its own or through a representative, in regular and systematic solicitation of business in the taxing State and the magnitude of the contacts satisfies notions of fairness and substantial justice in imposing a use tax collection duty.~~

B. *Commerce Clause Nexus*. "Substantial nexus" is the term that describes the Commerce Clause component of nexus. Substantial nexus protects interstate and foreign commerce from unreasonable burdens that would impair the free flow of that commerce. Nexus is not substantial if minimum contacts nexus does not exist.

1. ~~Under~~ The substantial nexus concept adds nothing to minimum contacts nexus in the case of a sales tax (whether in vendee, vendor or combined form) on may be applied to a taxable sale in which concluded by an out-of-state business is the purchaser. When the taxable sale occurs in the taxing State See Section II.A.1. above.

2. The substantial nexus concept adds nothing to minimum contacts nexus in the case of a sales tax in vendee form on a taxable sale in which an out-of-state business is the purchaser. See Section II.A.2. above.

3. ~~2.~~ Under The substantial nexus concept adds nothing to minimum contacts nexus in the case of a use tax (whether the sales tax for which the use tax compensates is a vendee, vendor, or combined form) on ~~may~~ be applied to a taxable use of the out-of-state business, when the taxable use occurs in the taxing State.
4. ~~3.~~ Under substantial nexus, a use tax collection duty may be imposed on an **out-of-state business**, when the connection between the out-of-state business and the taxing state is substantial. A conclusion that the connection is substantial necessarily means that the burden on interstate commerce that results from imposition of the use tax collection burden on the out-of-state business is reasonable; a conclusion that the connection is insubstantial means that the burden is unreasonable. A substantial connection between the out-of-state business and the taxing State requires that the out-of-state business have a substantial physical presence in the taxing State. In determining substantiality, physical presence significantly associated with the establishment and maintenance of a market in the taxing State with respect to the sale for which the possible use tax collection duty may be imposed counts more heavily than a comparable extent of other physical presence.
- a. ~~The out of state business is physically present in the taxing State, provided, the out of state business has not established that its presence is de minimis; or~~
- b. ~~The out of state business lacks a physical presence in the taxing State is not limited to contact with its customers by common carrier or the U.S. mail and the imposition of a use tax collection duty does not unreasonably burden interstate or foreign commerce.~~

[From this point on, detailed edits were not performed. See Comments for some suggested language changes and other ideas on a section by section basis.]